



Fact Sheet – Family Trusts

The term family trust refers to a discretionary trust set up to hold a family's assets or to conduct a family business. Generally, family trusts are established for asset protection or taxation purposes.

The Basics

A family trust is generally established by a family member for the benefit of members of the 'family group'. The trust:

- can assist in protecting the family group's assets from the liabilities of one or more of the family members (for instance, in the event of a family member's bankruptcy or insolvency)
- provides a mechanism to pass family assets to future generations
- can provide a means of accessing favourable taxation treatment by ensuring all family members use their income tax "tax-free thresholds"
- can be the subject of a family trust election which provides it with certain tax advantages, provided that the trust passes the family control test and makes distributions of trust income only to beneficiaries of the trust who are within the 'family group'.

A family trust has many other potential benefits, including avoiding issues such as challenges to the will following a death of a member of the family.

Trust deed

The terms and conditions under which a family trust is established and maintained are set out in its deed.

The trustee

The trustee is responsible for the trust and its assets. The trustee has broad powers to conduct the trust, and manage its assets.

The trustee is appointed by the Appointer, who also has the power to remove and replace trustees.

In a family trust, the trustees are usually Mum and Dad (or a company of which Mum and Dad are the shareholders and directors). Their children and any other relatives are usually listed as beneficiaries.

The use of a corporate trustee has some benefits including greater estate planning flexibility and potential increased asset protection this comes with a corporate beneficiary.

Family Trust income

One of the key benefits of a family trust is that the trustee can distribute income earned by the trust (from the trust property) in any way they see fit, provided distributions are made to people who qualify as beneficiaries. They do not have to make trust distributions in any particular proportion or in the same proportions as they did in previous years.

A trust does not have to pay income tax on income that is distributed to the beneficiaries, but does have to pay penalty tax on undistributed income. The trustee is free to distribute trust income to as many beneficiaries as are available and in proportions that take best advantage of those beneficiaries' personal marginal tax rates. The beneficiaries then pay the tax on distributions made to them.

For example, if an adult beneficiary of the trust only receives income from a trust and has the benefit of the tax-free threshold (currently \$6,000) for the year, the trustee could distribute part of the family trust's income to this person.

The result is that the beneficiary will receive some income but may not have to pay tax if that amount is less than \$6,000. If the distribution to the beneficiary exceeds his or her tax-free threshold, the excess amount will be taxed at the beneficiary's personal marginal tax rate.

Distributions received from a trust do not qualify as 'a special form of income', but instead form part of a beneficiary's assessable income. If the beneficiary receives income from other sources in addition to distributions from the trust, all of the income will be taxed together.

Even if the beneficiary's income does exceed the tax-free threshold for a particular year, the rate of tax applied to the amount of the excess income over the tax-free threshold may be lower than for other beneficiaries because of the total income that these other beneficiaries already receive.

Undistributed income is taxed in the hands of the trustee at the top marginal tax rate of 46.5% for the 2009/2010 year (including Medicare Levy), giving a strong incentive to family trusts to fully distribute the trust's income before the end of each financial year.

The trustee should also take care in relation to which beneficiaries are chosen to receive distributions, as penalty tax rates can apply to distributions made to minors (ie those under 18 years old).

Family trust income distributions and a word from the ATO

One important aspect of a family trust that must be kept in mind is to whom the distributions are made.

First, all distributions must be made only to people who qualify under the terms of the trust deed to be beneficiaries of the trust.

Secondly, for trusts that have made a family trust election, the distributions may only be made to beneficiaries who are within 'the family group'. In relation to this the ATO states on its website - "A consequence of making a family trust election is that any distributions (broadly defined) outside the family group of the family trust by the trust will be taxed at the top marginal rate applying to individuals plus the Medicare levy". That is, if a family trust makes a family trust election and then pays out to someone not a member of the family group, they will be taxed at the maximum rate possible.

Disclaimer

This Fact Sheet has been prepared for general information purposes only and not as specific advice to any particular person. Any advice contained in this document is General Advice and does not take into account any person's investment objectives, financial situation and particular needs.

Before making any investment decision based on this advice, you should consider, with or without the assistance of a financial adviser, whether it is appropriate to your particular investment needs, objectives and financial circumstances.

The information on this Fact Sheet has been sourced from www.ato.gov.au and www.fido.gov.au.



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